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# SPAC insights:

## Why so many companies are choosing SPACs over IPOs

Many private companies thinking of going public want to know if merging with a SPAC would be preferable to an IPO. The short answer: It depends. While a private company may find certain advantages in a SPAC merger—such as speed and a guaranteed price—it has its own challenges. One of the greatest of these is finding the best-fit SPAC sponsor in a sea of possibilities.

## SPACs versus IPOs

In an IPO, a private company issues new shares and, with the help of an underwriter, sells them on a public exchange.[1] In a SPAC transaction, the private company becomes publicly traded by merging with a listed shell company—the special-purpose acquisition company (SPAC).

## Going public with a SPAC – pros

The main advantages of going public with a SPAC merger over an IPO are:

— **Faster execution than an IPO:** A SPAC merger usually occurs in 3–6 months on average, while an IPO usually takes 12–18 months.

— **Upfront price discovery:** Your IPO price depends on market conditions at the time of listing, whereas you negotiate the pricing with the SPAC before the transaction closes—which is much more advantageous in a volatile market.

— **Possibility of raising additional capital:** SPAC sponsors will raise debt or PIPE (private investment in public equity) funding in addition to their original capital to not only fund the transaction but also to fuel growth for the combined company. This backstop debt and equity are intended to ensure a completed transaction even if some SPAC investors redeem their shares.

— **Lower costs of marketing:** A SPAC merger doesn't need to generate interest from investors in public exchanges with an extensive roadshow (although raising PIPE involves targeted roadshows).

— **Access to operational expertise:** SPAC sponsors often are experienced financial and industrial professionals. They can tap into their network of contacts to offer management expertise or take on a role themselves on the board.

[1] A similar option is a direct listing, where a private company only sells existing shares on a public exchange without an underwriter.

## Going public with a SPAC – cons

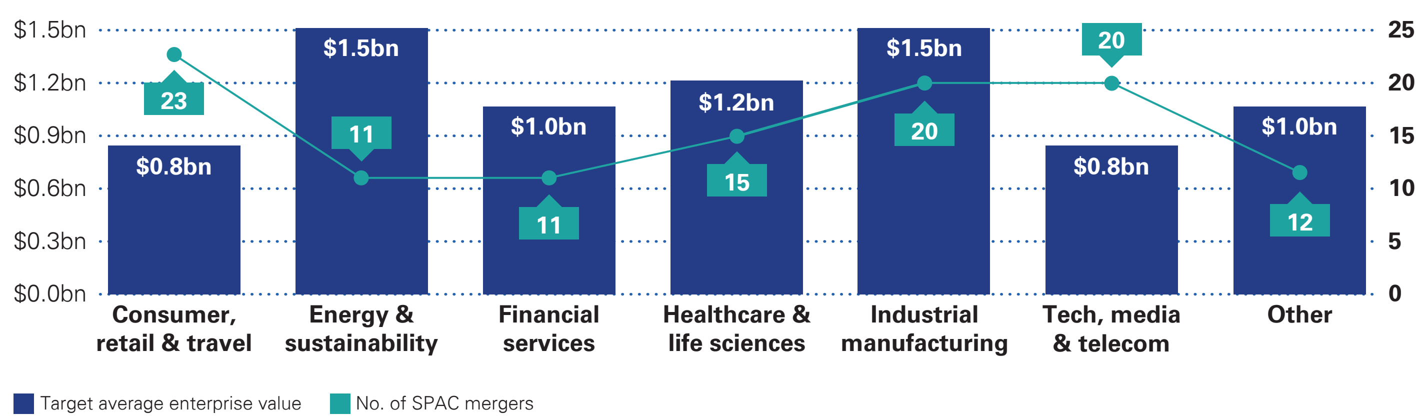
The main risks of going public with a SPAC merger over an IPO are:

- **Shareholding dilution:** SPAC sponsors usually own a 20 percent stake in the SPAC through founder shares or "promote," as well as warrants to purchase more shares. SPAC sponsors also benefit from an earnout component, allowing them to receive more shares when the stock price achieves a specified target over a certain time frame which could lead to further dilution.
- **Capital shortfall from potential redemption:** Initial SPAC investors may redeem their shares. If redemptions exceed expectations, then cash availability becomes uncertain and forces SPACs to raise PIPE financing to fill the resulting shortfall.
- **Compressed timeline for public company readiness:** Although the SPAC sponsor may offer help during the merger process, the target company usually takes the brunt of preparing for required financials in the SEC filings and establishing public company functions, such as investor relations and internal controls, under a much shorter deadline than in an IPO.[2]
- **Financial diligence performed at narrower scope:** The SPAC process does not require the rigorous due diligence of a traditional IPO, which could lead to potential restatements, incorrectly valued businesses or even lawsuits.
- **Lack of underwriting and comfort letter:** In a traditional IPO, the underwriter makes sure all regulatory requirements are met but because a SPAC is already public, the target company doesn't have an underwriter.

## What SPACs looked for in a target

For private companies interested in pursuing a SPAC merger, a quick analysis of recently completed transactions may be helpful in gauging the prospects for their own deals in the future. Between 2018 and 2020 when the current SPAC boom took off, the largest deals in terms of size and volume were in industrial manufacturing, likely due to the attractiveness of futuristic sectors such as electric vehicles and space tourism (Exhibit 1).

### Exhibit 1. Number of mergers and average enterprise value (2018–2020)



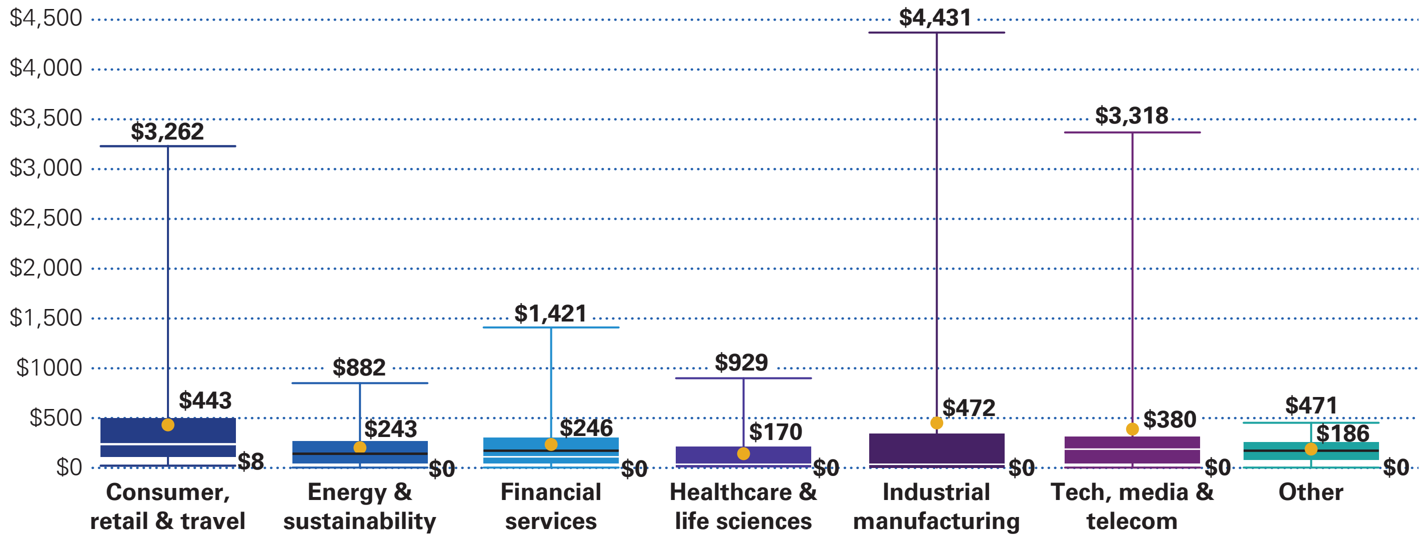

Source: KPMG data analytics based on SEC filings, Capital IQ, Thomson ONE and SPACInsider data

[2] See KPMG, "SPAC insights: Public company readiness," January 2021.

By revenue, most target companies fell under the $500 million range regardless of the industry (Exhibit 2). The three biggest targets, all with revenue of more than $3 billion, were in 1) industrial manufacturing, 2) technology, media and telecom, and 3) consumer, retail and travel. But the relatively modest revenue sizes indicate that many SPAC targets are valued for their future financial potential.

## Exhibit 2. SPAC target companies usually have modest revenue (2018–2020)

Targets' last 12-month revenue at merger close date ($m) – mergers completed in 2018–2020

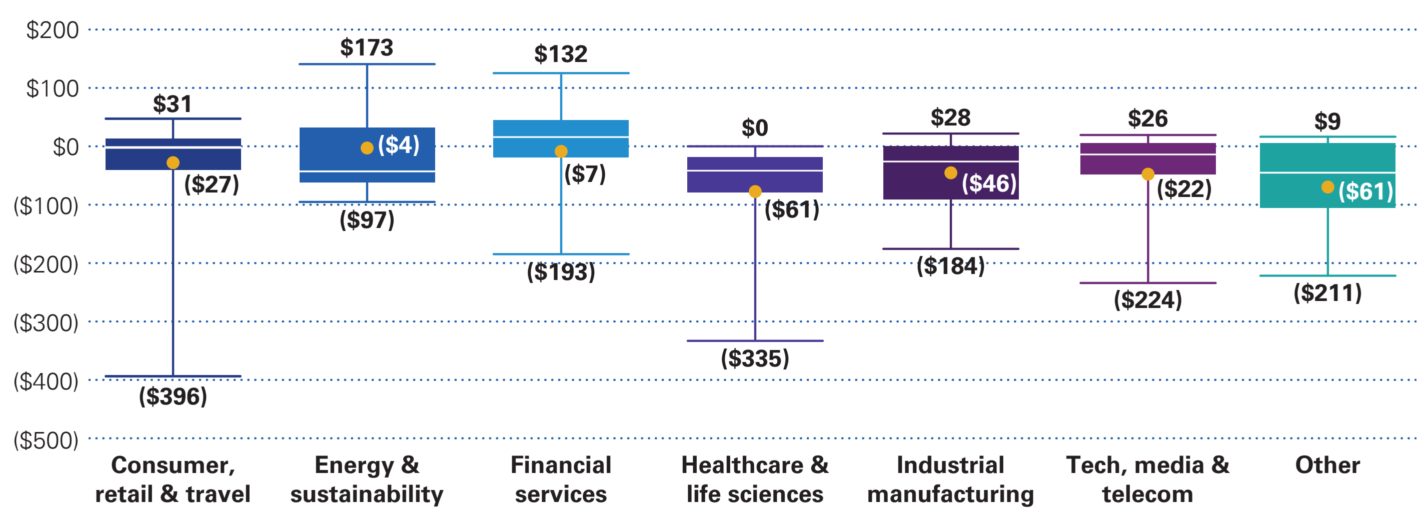



Source: KPMG data analytics based on SEC filings, Capital IQ, Thomson ONE and SPACInsider data

A look at net income makes it even clearer that SPAC targets tend to be developing companies. Across all industries, a vast majority of the companies merging with SPACs in the last two years were not yet profitable (Exhibit 3). Most of them showed losses of $100 million or less, but a couple of the targets—in consumer, retail and travel, and healthcare and life sciences—were more than $300 million in the red. Meanwhile, the two most profitable targets were $173 million (energy and sustainability) and $132 million (financial services) in the black.

## Exhibit 3. SPAC target companies by net income (2018–2020)

Targets' last 12-month net income at merger close date ($m) – mergers completed in 2018–2020

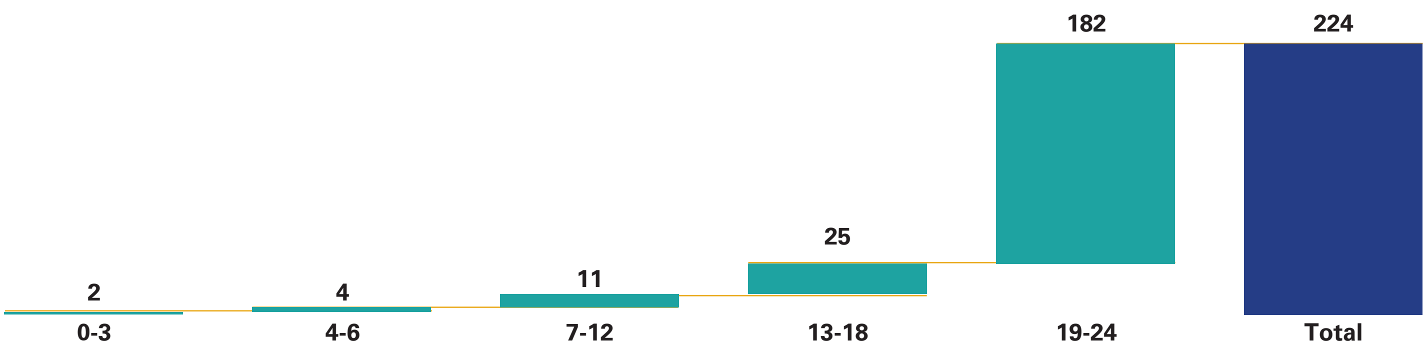



Source: KPMG data analytics based on SEC filings, Capital IQ, Thomson ONE and SPACInsider data

## 2021 SPAC outlook

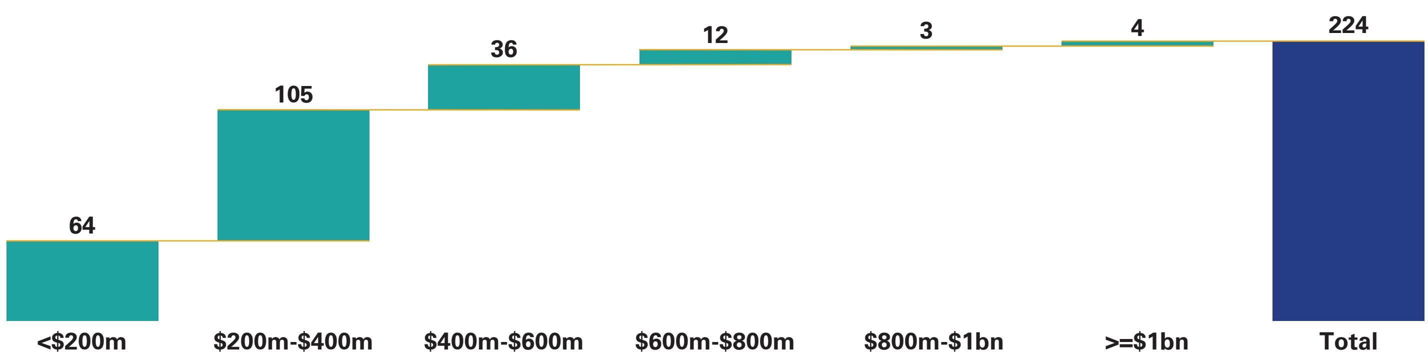
The recent flurry of SPAC launches means the demand for target companies is also soaring. As of the start of 2021, more than 200 SPACs are looking for targets (Exhibit 4).[3] And most of them must seal a merger within the next two years, given the typical lifecycle of 18-24 months for SPACs after which they must liquidate.

**Exhibit 4. Number of SPACs looking for target companies, by timeframe left (as of Jan. 1, 2021)**




Source: KPMG data analytics based on SEC filings, Capital IQ, Thomson ONE and SPACInsider data

**Exhibit 5. Number of SPACs looking for target companies, by amount raised (as of Jan. 1, 2021)**



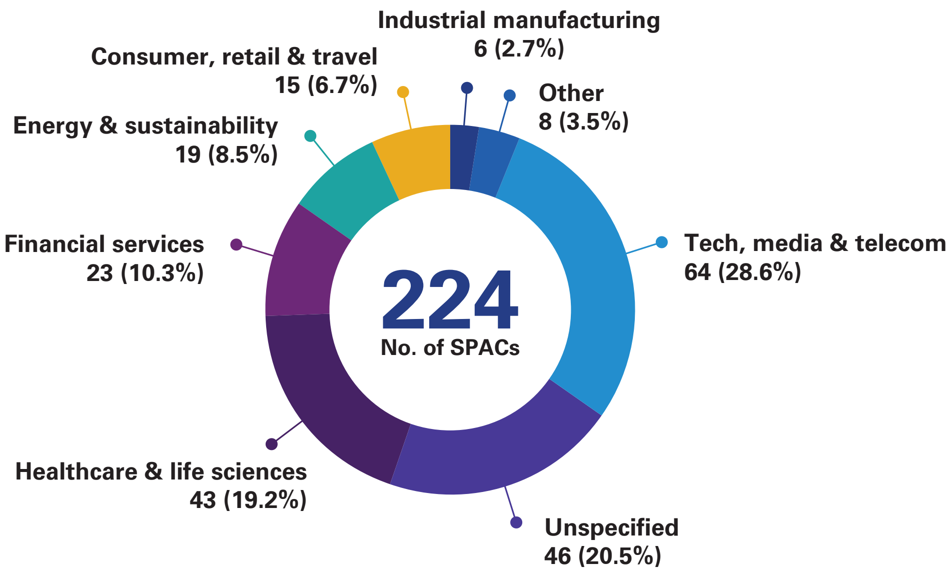

Source: KPMG data analytics based on SEC filings, Capital IQ, Thomson ONE and SPACInsider data

In addition to these timelines, two other factors drive a SPAC's search for targets: the SPAC's capital and industry preference. Exhibit 5 shows that about half of SPACs have $200 million to $400 million at their disposal and slightly more than a quarter have less than $200 million to spend. But the ability of SPACs to raise additional capital through debt and PIPE funding means they can pursue deals that are two or three times those amounts.

[3] The trend has continued and as of mid-February 2021, there were 331 SPACs looking for targets.

Not all SPACs target specific industries, but almost 80 percent do (Exhibit 6). Almost half of them focus on technology, media and telecom (28.6 percent), and healthcare and life sciences (19.2 percent).

**Exhibit 6. Number of SPACs looking for target companies, by industry (as of Jan. 1, 2021)**




Source: KPMG data analytics based on SEC filings, Capital IQ, Thomson ONE and SPACInsider data

## Bottom line

Going public by merging with a SPAC rather than by launching an IPO is worth considering for an increasing number of private companies. All the SPACs courting targets at this time may make M&A seem even more enticing. But there are pros and cons to each option. One way to decide which is the better one is to survey the current SPAC landscape and see if your company would really be comfortable exploring there. If you do, the next step is to find the right SPAC suitor that matches your specific criteria (which is the topic of an upcoming paper, "Diligencing SPACs").

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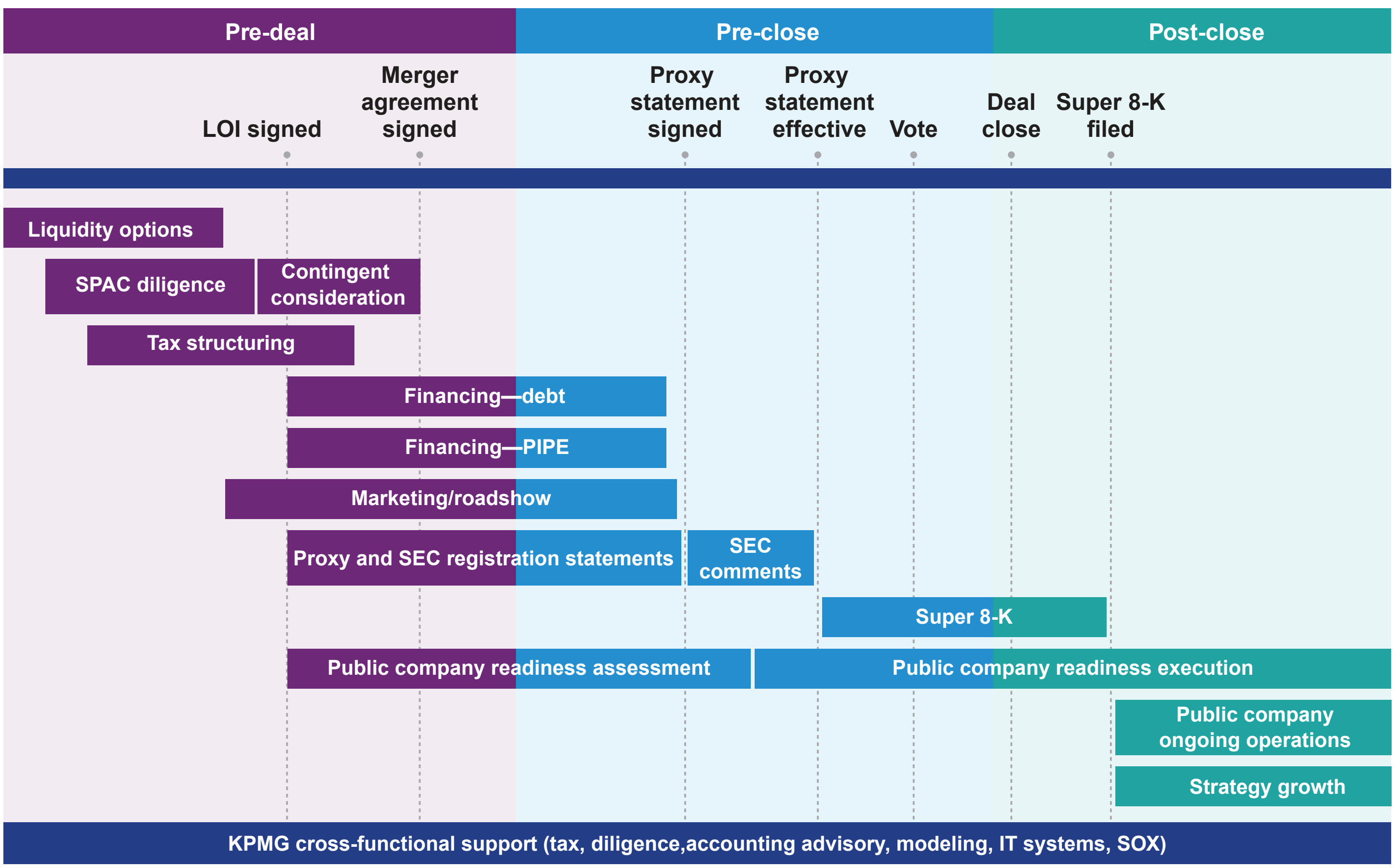
## SPAC transaction lifecycle

A SPAC has a typical lifespan of 18–24 months, but completing a merger with a SPAC can take as little as six months after the signing of an initial agreement. This paper focuses on the pre-deal phase of liquidity options. But across the lifecycle of a SPAC transaction, many other issues will arise. For more on these, visit the KPMG SPAC Intel Hub.

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